

Small Business Administration

§ 107.1840

issued before April 25, 1994, you must comply with paragraphs (e) and (f) of this section and the Capital Impairment regulations in this part in effect when you issued your Leverage. For all Leverage issued, you must also comply with any contractual provisions to which you have agreed.

(b) *Significance of Capital Impairment condition.* If you have a condition of Capital Impairment, you are not in compliance with the terms of your Leverage. As a result, SBA has the right

to impose the applicable remedies for noncompliance in §§ 107.1810(g) and 107.1820(f).

(c) *Definition of Capital Impairment condition.* You have a condition of Capital Impairment if your Capital Impairment Percentage, as computed in § 107.1840, exceeds:

(1) For Section 301(d) Licensees, 75 percent.

(2) For Section 301(c) Licensees, the appropriate percentage from the following table:

MAXIMUM PERMITTED CAPITAL IMPAIRMENT PERCENTAGES FOR SECTION 301(C) LICENSEES

If the percentage of equity capital investments (at cost) in your portfolio is:	And your ratio of outstanding leverage to leverageable capital is:	Then your maximum permitted capital impairment percentage is:
67%	100% or less	70
	Over 100% but not over 200%	60
	Over 200%	50
At least 40% but under 67%	100% or less	55
	Over 100% but not over 200%	50
	Over 200%	40
Under 40%	100% or less	45
	Over 100% but not over 200%	40
	Over 200%	35

(d) *Phase-in of maximum permitted Capital Impairment Percentages for Section 301(c) Licensees.* If you are a Section 301(c) Licensee, regardless of your maximum permitted Capital Impairment Percentage under paragraph (c) of this section, you will not have a condition of Capital Impairment if:

(1) Your Capital Impairment Percentage does not exceed 50 percent; and

(2) You have not reached your first fiscal year end occurring after April 25, 1995.

(e) *Quarterly computation requirement and procedure.* You must determine whether you have a condition of Capital Impairment as of the end of each fiscal quarter. You must notify SBA promptly if you are capitally impaired.

(f) *SBA's right to determine Licensee's Capital Impairment condition.* SBA may make its own determination of your Capital Impairment condition at any time.

[61 FR 3189, Jan. 31, 1996, as amended at 63 FR 5873, Feb. 5, 1998]

§ 107.1840 Computation of Licensee's Capital Impairment Percentage.

(a) *General.* This section contains the procedures you must use to determine your Capital Impairment Percentage if you have outstanding Leverage issued after April 25, 1994. You must compare your Capital Impairment Percentage to the maximum permitted under § 107.1830(c) to determine whether you have a condition of Capital Impairment.

(b) *Preliminary impairment test.* If you satisfy the preliminary impairment test, your Capital Impairment Percentage is zero and you do not have to perform any more procedures in this § 107.1840. Otherwise, you must continue with paragraph (c) of this section. You satisfy the test if the following amounts are both zero or greater:

(1) The sum of Undistributed Net Realized Earnings, as reported on SBA Form 468, and Includible Non-Cash Gains.

(2) Unrealized Gain (Loss) on Securities Held.

(c) *How to compute your Capital Impairment Percentage.* (1) If you have an Unrealized Gain on Securities Held, compute your Adjusted Unrealized Gain using paragraph (d) of this section. If you have an Unrealized Loss on Securities Held, continue with paragraph (c)(2) of this Section.

(2) Add together your Undistributed Net Realized Earnings, your Includible Non-cash Gains, and either your Unrealized Loss on Securities Held or your Adjusted Unrealized Gain.

(3) If the sum in paragraph (c)(2) of this section is zero or greater, your Capital Impairment Percentage is zero.

(4) If the sum in paragraph (c)(2) of this section is less than zero, drop the negative sign, divide by your Regulatory Capital (excluding Treasury Stock), and multiply by 100. The result is your Capital Impairment Percentage.

(d) *How to compute your Adjusted Unrealized Gain.* (1) Subtract Unrealized Depreciation from Unrealized Appreciation. This is your “Net Appreciation”.

(2) Determine your Unrealized Appreciation on Publicly Traded and Mar-

ketable securities. This is your “Class 1 Appreciation”.

(3) Determine your Unrealized Appreciation on securities that are not Publicly Traded and Marketable and meet the following criteria, which must be substantiated to the satisfaction of SBA (this is your “Class 2 Appreciation”):

(i) The Small Business that issued the security received a significant subsequent equity financing by an investor whose objectives were not primarily strategic and at a price that conclusively supports the Unrealized Appreciation;

(ii) Such financing represents a substantial investment in the form of an arm’s length transaction by a sophisticated new investor in the issuer’s securities; and

(iii) Such financing occurred within 24 months of the date of the Capital Impairment computation, or the Small Business’ pre-tax cash flow from operations for its most recent fiscal year was at least 10 percent of the Small Business’ average contributed capital for such fiscal year.

(4) Perform the appropriate computation from the following table:

ADJUSTED UNREALIZED GAIN BEFORE ESTIMATED TAX EFFECTS

If:	And:	Then adjusted unrealized gain before taxes is:
Class 1 Appreciation ≤ Net Appreciation.	Class 1 Appreciation + Class 2 Appreciation ≤ Net Appreciation.	(80% × Class 1 Appreciation) + (50% × Class 2 Appreciation).
Class 1 Appreciation ≤ Net Appreciation.	Class 1 Appreciation + Class 2 Appreciation > Net Appreciation.	(80% × Class 1 Appreciation) + [(50% × (Net Appreciation – Class 1 Appreciation))].
Class 1 Appreciation > Net Appreciation.	80% × Net Appreciation.

(5) Reduce the gain computed in paragraph (d)(4) of this section by your estimate of related future income tax expense. Subject to any adjustment required by paragraph (d)(6) of this section, the result is your Adjusted Unrealized Gain for use in paragraph (c)(2) of this section.

(6) If any securities that are the source of either Class 1 or Class 2 Appreciation are pledged or encumbered in any way, you must reduce the Adjusted Unrealized Gain computed in paragraph (d)(5) of this section by the amount of the related borrowing or other obligation, up to the amount of

the Unrealized Appreciation on the securities.

§107.1850 Exceptions to Capital Impairment provisions for Licensees with outstanding Participating Securities.

The provisions in this §107.1850 apply only if at least two-thirds of your outstanding Leverage consists of Participating Securities, and at least two-thirds of your Loans and Investments (at cost) consist of Equity Capital Investments.

(a) *Forbearance period for Participating Securities issuers.* During the first forty-